

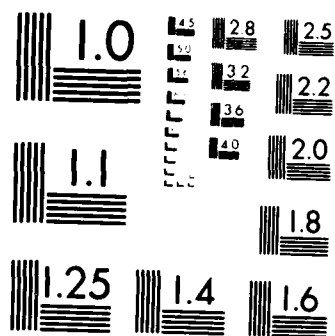
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# THESIS

STATE ECONOMIC ENTERPRISES AND TURKISH  
ECONOMY

by

Bulent Dogan

December 1987

Thesis Advisor

Fenn Horton

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State Economic Enterprises and Turkish Economy

by

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Submitted in partial fulfillment of the  
requirements for the degree of

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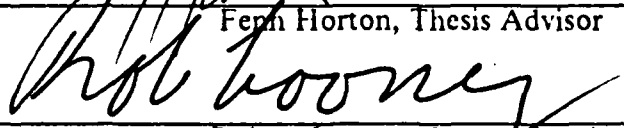
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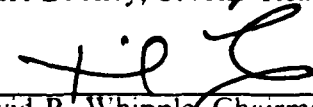
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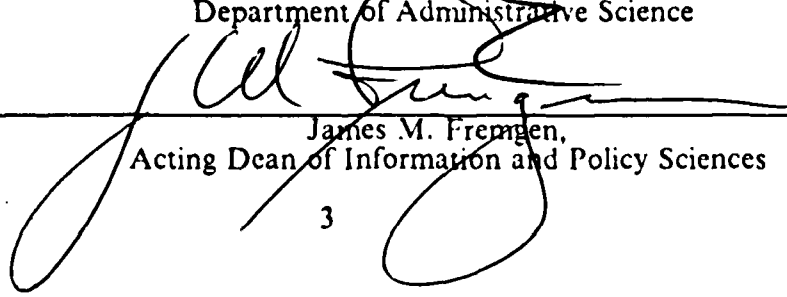
  
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## ABSTRACT

In Turkey, the state had a stake in economic affairs, either in terms of orientation of economic life or in terms of state managed enterprises, both before and after the Republic. In the early years of the Republic, the state, instead of developing the productive potential of the state-owned enterprises, and reorganizing them to increase their effectiveness, continued to operate them as they were.

After the 1930s, a considerable number of State Economic Enterprises (SEEs) were established with different legal structures. The attempts at reforming and reorganizing the administration of these enterprises increased in frequency. Since 1960, the scope of SEEs' economic activities has been further extended, in spite of their continued operation at low levels of productivity under inefficient management. The need for the State Economic Enterprises to improve their efficiency so as to provide savings, their transformation is a vital aspects of Turkey's modernization.

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## I. INTRODUCTION

### A. BACKGROUND

Turkey had different development strategies pursued and the performance of the economy in different periods and subperiods since the foundation of the new Turkish Republic in 1923. 1923-38 Ataturk Period, 1950-60 Unplanned period, 1962 and since Planned period.

1934-48 is the period of implementation of the first industrial development plan in which an effort for achieving rapid industrialization was made under the etatite economic regime. [Ref. 1: p. 295] After development received attention, in accordance with the proceedings of Izmir Congress held in 1923, the strategy of encouragement of the private sector was stressed. With the law of encouragement of industry put in force in 1927, private industrial investments were encouraged through various means available. But private savings and investments were not adequate at the time to achieve a satisfactory rate of economic growth and industrialization. The government accepted in 1934 the principles of etatisme, that is giving the leading role to the state and State economic enterprises (SEEs) in attaining rapid growth and industrialization.

Etatism has been defined as intervention of the state as a pioneer and director of industrial activity, in the interest of national development and security, in a country in which private enterprise is either suspect or ineffective.

A philosophy regarding the role and strategy of state enterprise -development of basic industries and new industries of advanced technology, for example- has to be translated into specific individual enterprise objectives and investment decision. Integrity in objectives is important in itself; it is also necessary for unambiguous measures of performance.

Several considerations must be taken into account in fixing the objectives of the state enterprises. Like as; financial return, economic return, capital intensity and labor intensity, and dynamic growth.

During the 1930s, two new development bank were established to finance and control the expanding state industrial sector. The first of these, Sumerbank (Sumerian Bank), was set up in 1933 with a nominal capital of TL 20 Million, increased in successive stages to TL 200 Million by 1946.

In 1935 a second state agency, Etibank (Hittite Bank) was established, with primary responsibility for the mining industry. Etibank acquired total responsibility for the mining industry.

During 1950-59, a crucial area of policy, as always, was the relative weight to be attached to the state and private sectors in industrial development. Early stages of development required the building up of infra-structure and basic expansion of basic industrial and agricultural materials by means of public investments and SEEs. Originally, the SEEs were supposed to operate with a high degree of autonomy and to strive for profits as a private business would have done.

During the first four decades of the Republic pro-and anti-etatist arguments tended to dominate discussion of development policies in Turkey. The assumption that the state sector had the major responsibility for industrialization was questioned during the late 1940s. The period of the first two five-year plans saw a distinct switch of official emphasis on the role of the state in industrial development. The third and fourth five-year plans concentrate on the need to improve the efficiency of existing SEEs, rather than urge the reduction or increase of the state's industrial role. Fourth five-year plan (1979-83) deals at some length with the prospect of "broadly based people's entrepreneurship", but admits that little has been achieved in this direction.

State Economic Enterprises (SEEs) have been an effective tool in the implementation of the industrialization programs and activities in Turkey. In spite of various administrative problems that these organizations have faced, their contributions to the adaption of modern technology, manpower, training, creation of employment opportunities, production and price stability have been of great help to the developmental efforts during the first two plan period.

Even if it is agreed that the venture into state enterprise was of crucial importance to the economic development of Turkey, its performance so far nevertheless raises serious questions as to its ability to function well and the degree of emphasis that should be given it in the future. Some of its more significant weaknesses can be summarized as follows:

- a. Industrial development was pulled excessively in the direction of capital-intensive import substitution.
- b. The dualism between the state and private sectors introduced inflexibilities and antagonisms rather than mutually supportive structures capable of evolution and adaptation.
- c. The state industrial empire was neither well administered nor well managed.

Whether and what extent these weaknesses of state enterprise can be overcome is an important consideration in planning the future industrial development of Turkey.

**TABLE 1**  
**RELATIVE IMPORTANCE OF STATE ECONOMIC ENTERPRISES**  
**IN TURKISH INDUSTRY IN SELECTED YEARS**

Sector (%)	1950	1963	1967	1973	1979
Processed food	48	34	42	32	37
Beverages	98	89	87	60	40
Tobacco	68	77	88	81	91
Textiles	42	25	22	17	12
Wearing apparel	95	75	58	17	15
Wood Products	54	56	43	27	31
Furniture	0	0	0	32	12
Paper	90	91	81	69	60
Printing	15	11	18	8	10
Leather products	0	0	0	0	20
Chemicals	9	30	17	21	23
Petroleum products	100	100	98	90	87
Non-Metalic Products	20	38	40	24	18
Iron and steel	91	86	74	61	46
Metal products	60	38	32	3	11
Machinery	78	26	16	27	21
Electrical Mach.-electronics	0	1	1	2	2
Transport equipment	99	60	39	26	14
Other manufacturing	0	0	0	1	8
All manufacturing	51	44	48	37	32

Source: State Institute of Statistics

As can be seen in Table 1, the relative importance of the SEEs varies from sector to sector and from year to year. SEEs are in general much larger than average private sector firms. Substantial changes in their share of output usually reflect the start of new plants. Until the late 1960s, the shares of the public and private sectors in manufacturing industry were about even [Ref. 2: p. 134]. The SEEs were employed as an instrument to restrain inflation in the 1950s, their prices being kept low. Simultaneously, the planlessness of the economy enabled the SEEs to undertake

investments autonomously. The result was, highly inflationary, and an effort was made in the early 1960s to gain control over the investments of the SEEs and to improve their efficiency. A major issue, and one that emerged repeatedly since 1950, is how the SEEs should be organized to increase their efficiency and lower costs. The State Investment Bank and State Planning Organization (SPO) are both heavily involved in determining the level and composition of public sector investments. Part of motive for that control lies in the setting of industrial priorities, and part originates in the experience of the late 1950s. The problems associated with the organization and functioning of public sector enterprises are, in principle, somewhat separate from the determination of industrial priorities. In practice, however, the two issues are interrelated, especially when the instruments available to alter private sector behaviour do not bring about the desired results.

In 1975, however, the finances of the state sector began to go drastically wrong. On the other hand, the oil price explosion and wage demands by an increasingly unionized workforce gave a dramatic push to costs. As a result, those enterprises slumped into the red.

The overall deficit of the SEEs climbed to almost TL 9 Billion in 1977, with still bigger losses likely in 1978 and 1979. The Enterprises had thus become a serious drain on public funds.

A major cause of inefficiency was over-staffing, often pressed forward by politicians who seemed to regard the state industries as a substitute for a proper system of unemployment insurance. Between 1970 and 1978 the total workforce of the SEEs rose from 362,000 to over 650,000 at a higher rate than that of output. On the other hand, the SEEs have experienced a serious shortage of technical and managerial personnel, since the salaries they are allowed to pay are far lower than those offered for comparable jobs in private sector. The result is a cripplingly high turnover of managers.

It was not until early 1980 that the new Justice Party government made a determined effort to reduce the deficits of the SEEs. Under a cabinet decree of 1 February, the list of basic goods and services, whose prices could be fixed by the government, was shortened to include only coal, chemicals and fertilizers, besides the freight and passenger services of the railways and State Maritime Lines. The prices of all other goods and services produced by SEEs were henceforth to be determined by the enterprises concerned. This decree was accompanied by a sharp increase in the

prices of SEE and State monopoly products. Nevertheless, the prices of many state-produced goods and services still remained remarkably low by western European standards.

## **B. STRUCTURE**

The primary aim of this study is to describe the effects of the State Economic Enterprises (SEEs) on Turkish economy and approaches to the organization development in the SEEs.

The background prior to the five-year plan periods is provided in chapter II, which outlines the economic development in Turkish economy during the decade immediately preceding the planning era.

In chapter III the general objectives and framework of the development plans and basic economic policy in Turkish economy are discussed. The development of SEEs and the effects of them are discussed in chapter IV.

State Economic Enterprises have been an effective tool in the implementation of the industrialization programs and activities in Turkey. But their performance so far nevertheless raises serious questions as to their ability to function well and the degree of emphasis that should be given it in the future. The basic problems and the reorganization proposals for SEEs and conclusions to this study are discussed in chapter V and VI, respectively.



## II. TURKEY'S ECONOMIC SITUATION BEFORE THE PLAN PERIOD

### A. THE EVOLUTION OF ECONOMIC POLICY, 1923-30

In 1933 at the height of the world economic depression, the new state of Turkey, a republic then barely ten years old, became the very first of "Third World" nations to undertake a planned economy. A doctrinal foundation for state planning had been laid two years before with the official adoption of etatism (stateism), which called for artificial simulation of the economy through government intervention. During the first ten years of the Republic, the government in Ankara adhered to specifically Laissez-faire economic policies that had been spelled out early in 1923 by a national economic congress held at Izmir, during the interval between the two sessions of the Lausanne Peace Conference.

Nearly a thousand delegates had been selected to present their respective occupational groups, were so divided for purposes of discussion while at the congress. President Mustafa Kemal (Ataturk) departed immediately after giving the opening address and left the running of the congress entirely in the hands of General Kazim Karabekir. Under his leadership the congress approved a document called the Economic Pact. The congress established the guidelines for state and private sector activity during the first years of the Republic, prior to the official adoption of etatism in 1931 [Ref. 3: p. 375].

In the course of the Izmir Congress of 1923 two crucial policy issues were debated at length. The first concerned the role of the state in the development of the economy. In his address to the delegates Mahmut Esat Bozkurt, The Minister of Economy, outlined the government's ideological stance:

We are not attached to Laissez-faire, socialist, communist, etatist or protectionist schools of thought. We have a new school of thought which belongs to new Turkey and correspond to a new economic outlook. I call it the new Turkish Economic School. [Ref. 4: p. 262] The new Turkey should follow a mixed economic system, Economic Enterprises should be undertaken partly by the state and partly by private individuals. For example, the state should direct large scale credit and industrial undertakings. [Ref. 5: p. 39]

In general, however, it was to become clear that the government was initially ready to allow private enterprise the major role in industrial development, and to limit

direct government intervention to basic public utilities and certain state monopolies which had a primarily fiscal purpose.

A second critical debate concerned the role of foreign capital in economic development. On this score it is sometimes assumed that the new regime was hostile to foreign investment. This view is not supported by contemporary declarations and actions. It is certainly true that the the republican government was determined to avoid indebting the state to foreign bondholders. On the other hand, they were fully prepared to allow foreign investors to undertake specific projects.

After 1923 the government began a massive extension of the railway network. Apart from the railways, direct government investment was mainly limited to the state monopolies. These had been established primarily to raise revenue, but they did give the government an interest in developing the industries concerned. The most important of these was the government's tobacco monopoly. In 1925 it was bought out by the government and the monopoly transferred to a Provisional Tobacco and Cigarette Paper Monopoly Administration. Only the export of unprocessed leaf was left in private hands. Once in control, the government ran the monopoly as an industrial model. By the early 1930s it had four cigarette factories, employing around 2500 workers, and had raised the annual output of tobacco products to around 11,000 tonnes, from 7,500 tonnes in 1925. By 1926, however, it was realised that the liquor trade was a useful potential revenue raiser, and the manufacture of alcoholic drinks was transferred to the Monopolies Administration. Other government monopolies were established for matches and explosives and the import of sugar and oil products.

Although agriculture was obviously the basic source of Turkey's wealth, the government played a less active role in its development. Its principal medium of intervention was the agricultural Bank which was reorganized in 1924. Its capital was then doubled to TL 50 Million and administrative bodies in the rural districts became its shareholders. By 1935 the Bank's loans to cultivators had risen to TL 35.7 Million, from just over TL 8 Million in 1923. Apart from this direct injection of capital, the government's most important aid to agriculture was in the fiscal field. Until 1925 the peasant had paid an annual tithe equivalent to 12.5 per cent of his produce. This was then abolished and partially replaced by a sales tax which was applied only to produce marketed outside the producer's village and shipped by sea or rail. Taxes on livestock were also continued. The tithe had accounted for just under 29 per cent of the government's total revenue in 1924, after its abolition, the gap in state finances was filled by an increase in the income from the monopolies.

**TABLE 2**  
**GOVERNMENT REVENUE AND EXPENDITURE,**  
**1913/14 TO 1929/30 (TL MILLION)**

Financial Year	Receipts	Expenditure	Receipts as % of expenditure	Retail Price index
1913/14	29.2	33.7	86.6	100
1917/18	31.7	60.3	52.5	-
1923/24	51.0	104.0	49.0	1,279
1924/25	111.3	135.2	82.3	1,343
1925/26	138.5	210.1	65.9	1,415
1926/27	170.4	179.9	94.7	1,466
1927/28	197.5	202.9	97.3	1,452
1928/29	204.6	204.2	100.2	1,474
1929/30	206.1	214.5	96.0	1,533

In the broader field of fiscal and monetary policy, one of the new regime's first priorities was to balance its budget. As Table 2 indicates the government had succeeded in balancing the budget by 1926, after previous massive deficits. This improvement was achieved by tightening up the collection of revenue, rather than cutting expenditures. [Ref. 5: p. 44]

Gross National Product for 1923, at current purchaser's prices, at TL 952.6 Million, raising to TL 1,650 Million in 1926 and then falling to TL 1,580 Million in 1930.

The data shown in Table 3 indicates several interesting trends. In the first place, although the respective shares of agriculture, industry and services in GNP do not show any consistent alteration during the period, the overall rise in national product undermines the frequently made assumption that the 1920s were years of stagnation for the Turkish economy. At an average of 11.4 per cent per year, the GNP growth rate actually compares favorably with later periods. On the other hand, it will be noticed that growth was far more pronounced during 1923-1926 than during 1926-1930, especially in agriculture; the GNP growth rate for the former period averages out at 15.8 per cent per year, falling to a more modest 4.1 per cent for 1926-30. These fluctuations can largely be accounted for by changes in the agricultural sector, where

the value added rose at a staggering 23 per cent per year during 1923-26, but at only 3.3 per cent per year during the following four years.

TABLE 3  
ESTIMATED NATIONAL INCOME, BY SECTORS, 1923-30

	1923	1925	1927	1929	1930	Av. Ann. % Increase
Agriculture	245.3	354.8	333.8	527.1	521.1	11.4
% of GNP	38.7	41.7	37.4	45.8	43.4	
Industry	80.0	88.9	122.6	126.6	142.8	8.6
% of GNP	12.6	10.4	13.7	11.0	11.9	
Services	289.8	366.9	396.8	453.2	487.9	7.7
% of GNP	45.7	43.3	44.5	39.4	40.7	
Import Taxes	24.9	41.0	45.4	48.3	55.0	
GDP	640.0	851.6	898.5	1152.2	1207.1	9.5
Net factor in. from abroad	-6.9	-5.4	-6.2	-5.1	-8.3	
GNP	633.1	846.2	892.3	1150.1	1198.8	9.6
Index (1923 = 100)	100.0	133.6	140.9	181.7	189.3	
GNP per Head (TL)	50.3	64.6	65.4	80.8	82.4	7.3

There are two likely explanations for this erratic growth. In the first place, climatic conditions favoured agriculture during the first three years of the Republic. Apart from this, recovery from wartime dislocation seems the most likely cause of the sharp increase in economic activity between 1923-26. Domestically produced goods began to replace imports. Before the war, Turkey had imported all her sugar; by 1927 the new beet-sugar factories were meeting just under 8 percent of consumption, rising to some 49 per cent in 1932. By 1930, the share of textiles and sugar in total imports had been reduced to about 35 per cent.

In spite of the growth of import replacement industries during the 1920's, the overall situation of Turkey's foreign trade was less encouraging.

**TABLE 4**  
**BALANCE OF VISIBLE TRADE, (MILLION \$ US)**

Year	Average value of \$ in TL	Imports	Exports	Total visible trade	Deficit/ Surplus	Deficit as % of total trade
1913/14	0.21	123.9	70.3	194.2	-53.6	27.6
1921	1.53	55.7	6.4	62.1	-49.3	79.3
1923	1.678	86.3	50.4	136.7	-35.9	26.3
1924	1.882	102.9	84.4	187.3	-18.5	9.9
1925	1.833	131.8	104.9	236.7	-26.9	11.4
1926	1.905	123.2	97.8	221.0	-25.4	11.5
1927	1.935	109.2	81.9	191.1	-27.3	14.3
1928	1.954	114.4	88.8	203.2	-25.6	12.6
1929	2.069	123.9	75.0	198.9	-48.9	24.6
1930	2.122	69.5	71.4	140.9	+ 1.9	-

As can be seen from Table 4, the substantial foreign trade deficit of pre-war days continued until 1923, but was thereafter reduced to around 10-15 per cent of Turkey's total foreign trade. The deficit increased again in 1929, however, as importers rushed to build up stocks before the imposition of the new, higher tariff. After this imports were cut back sharply, so that Turkey actually had a positive trade balance in 1930.

## **B. THE ETATIST ERA (1930-1950)**

### **1. Industrial Policy**

The Etatist Principles of economic development which were adopted by the regime during the 1930s have been subjected to any number of different definitions and interpretations. The regime itself generally preferred to define Turkish Etatism as a home grown product, arrived at by an objective analysis of Turkey's economic situation rather than dogmatic ideological commitments. In practice, it amounted to the assumption that the state had the major responsibility for undertaking new industrial investment, even if this left private entrepreneurs at a disadvantage.

The main practical expression of the etatist philosophy was Turkey's first five-year industrialization plan, which was drawn up in 1933 and put into operation between 1934 and 1938. Essentially, the plan provided for the establishment of a series of industrial plants designed to reduce Turkey's needs for imported consumer and intermediate goods using domestic raw materials. State agencies were to be responsible for financing, constructing and managing these plants. The main industries affected were the manufacture of cotton and wool textiles, paper, ceramics, glass, cement, semicoke and some chemical products, besides iron and steel. Emphasis was put on the industrialization of the backward regions of central and eastern Anatolia. In the event, most of this development was realised within the plan period, with the notable exception of the iron and steel mill.

To finance and control the expanding state industrial sector, two new development bank were established during the 1930s. The first of these, Sumerbank, was set up in 1923 with a nominal capital of TL 20 Million, increased in successive stages to TL 200 Million by 1946. Sumerbank took over the factories formerly run by the Bank for Industry and Mining, to which were added the majority of the new plants established under the plan. Apart from those under takings over which it had total control, Sumerbank also continued its predecessor's policy of investing part of its funds in private enterprises, in such fields as textiles, sugar, power generation, ceramics and sulphur.

In 1935 a second state agency, Etibank was established, with primary responsibility for the mining industry. Etibank's main activity was in the Zonguldak coal field, where it took over operations from the former French concessionary company in 1936. Apart from this, Etibank acquired total responsibility for the mining of iron ore and copper, competing with private enterprises in the production of lignite and chromite. Etibank was also nominally responsible for government-owned power installations: in fact, there was no national grid, and just under half the power generated came from municipally-owned plants.

The initial capital of Sumerbank and Etibank was subscribed by the government, or inherited in the form of assets from predecessor organizations. Subsequently, they derived their funds from further direct allocations from the budget, from government loans, in the form of advances from the central Bank on Treasury-guaranteed bills and from ploughed-back profits. From the beginning, they had also operated as commercial banks, opening branches and accepting deposits from the

public [Ref. 5: p. 57]. However, as time went on, these deposits represented a shrinking proportion of their total capital and liabilities. In other words, both organizations acted as state-owned holding companies with minor banking functions, rather than state-controlled banks.

It was only during World War II that the government took stringent measures to control the private as well as the state sector of the economy. Whatever her pre-war policies, Turkey, like other countries, was virtually compelled to introduce a new range of economic controls. In the process, the state sector increased its share of industrial output, at the expense of that of private industrialists. Production by the SEEs increased by around 49 per cent between 1939 and 1945, whereas that of the mechanized private sector rose by only 7 per cent.

The first economic casualty of the war was a second five-year industrialization plan, which was prepared in 1936, and intended to be put into operation during 1939-43 [Ref. 6: p. 3-9]. In the event the only important new plant initiated during the second plan period was the iron and steel mill, which had been provided for in the first plan, but did not begin production until the end of 1939. Although some new plants were opened during the war, they mainly sufficed to expand the industries established under the first plan.

After the decision to permit the organization of an opposition party, in the new Democrat party's 1946 programme the democrats stressed that they considered private enterprise one of the principal elements of the economy, that the limits of state economic activity should be clearly defined.

During the post-war period, Republican People's Party (RPP) government took some steps to put its new principles into practice. In particular, government monopolies in imported coffee, beer, wine and explosives were legally ended, beginning in 1946. On the other hand, the relative shares of the state and private sectors in the production of such items as cotton and woollen goods and cement, where private enterprise had an important role, did not alter dramatically between 1945 and 1950. Total industrial production grew by 2 per cent per year during the same period, but that value added in the state sector declined by an average of 0.7 per cent per year, while that of the private sector increased by 3.2-4.0 per cent. Overall, however, private industry's share of total value added in manufacturing had fallen from just under 80 per cent in 1938 to around 63 per cent in 1950 [Ref. 7: p. 74]. There was some recovery in the share of the private sector during 1945-1950.

## **2. Agricultural Policies**

The increase in demand for raw materials as a result of industrial expansion, together with the extension of the railway network, led to better prospects for those farmers who could produce such crops as beet or cotton. From an average of around 500,000 tonnes per year between 1928 and 1935, the output of industrial crops rose to an average of around 1.2 million tonnes for 1936-40 and 1.8 million tonnes for 1946-50.

The state's most important intervention in agriculture during the 1930s was in the field of price support. For the pre-war period, wholesale grain prices remained roughly stable during 1936-39, in line with the general price level. It is, of course, possible that this relative improvement in the farmer's position would have occurred. On the other hand, the Office of Soil Products which is state enterprise tended to set prices above world levels, so that the state's intervention may well have prevented further erosion of the farmer's terms of trade. Overall agricultural production, which had risen steadily during the 1930s, appears to have fallen during the war.

At the same time, grain prices rose sharply in the general inflationary conditions: from an index base of 100 in 1939, the average free market price of wheat reached a dizzying 929 by 1943, falling to around 560-70 during 1944-45. Farmers were unable to reap the full benefits of this rise, however, since the Office of Soil Products paid prices which were well below free-market levels especially during 1942-43.

At the end of the war, the regime attempted to tackle the general problem of rural poverty by enacting land reform legislation, but its efforts met with little success. [Ref. 5: p. 63]

## **3. Labor, Social Policy and Education**

Turkey's population growth rate fluctuated during the 1930s and 1940s. The average rate of increase stood at about 1.7 per cent per year for 1935-50, or an absolute rise of just under 4.8 million (from around 16.2 million to 20.9 million). What is perhaps surprising, in view of the emphasis on industrialization during this period, is the fact that there doesn't seem to have been any significant change in the structure of the workforce, indeed, industrial employment, as a proportion of the total, actually appears to have dropped. Table 5 shows that a higher proportion of entrants to the workforce was engaged in agriculture than industry.

Before World War II, various state economic enterprises, government departments and local authorities began to provide hospitals, clinics, and in some cases, retirement pension schemes for their own employees.



**TABLE 5**  
**ECONOMICALLY ACTIVE POPULATION, BY SECTOR, 1935-1950**

	1935	1950
Employment, by sector	%	%
Agriculture	81.8	85.7
Services	9.9	6.9
Industry	8.3	7.4

Education was the sphere of social policy in which the republican regime made its most consistent and concerted effort. Expenditures on education, as a proportion of the total budget, rose from 5 per cent in 1930, to 6 per cent by 1938 and 12 per cent by 1950 [Ref. 7: p. 148]. The pattern of state schooling provided for primary schools, teaching a five-year curriculum, could proceed to middle schools and, eventually, to high schools and universities. Craft and vocational colleges were also provided at each three higher levels, for graduates of schools at the previous stage.

The overall growth of the educational system between 1927 and 1950 is indicated in Table 6 .

**TABLE 6**  
**EDUCATION INDICATORS, 1927-50**

Years	Population (millions)	School enrollment (thousands)			
		Primary	Middle	High	University
1927	13.6	462.0	19.9	11.2	4.3
1940	17.8	813.6	85.0	27.6	10.2
1950	20.9	1,591.0	67.4	39.1	25.1

#### **4. Monetary and Fiscal Policy**

In general, the 1930s saw a continuation of the main principles of budgetary and monetary policy which the government had practised during the second half of the

previous decade. Inflation has been caused by excess demand, created through monetary expansion rather than cost-push factors-granted that, for instance, wages have represented a relatively small proportion of total production costs until very recent times. Since the interest paid on savings deposits has generally been well below the rate of inflation, bank customers hold savings as well as sight deposits for the sake

TABLE 7  
MONEY SUPPLY AND PRICES, (TL MILLIONS)

Years	Currency	Bank deposits	Total 1 + 2	% Rise in 3	% Rise in GNP	% Rise in prices
1933	198	129	327	-	13.4	-
1934	205	128	333	1.8	6.7	-
1935	212	132	344	3.3	-2.4	11.8
1936	221	153	374	8.7	19.1	10.4
1937	235	183	418	11.8	3.3	4.7
1938	240	201	441	5.5	8.8	-4.6
1939	318	190	508	15.2	8.3	4.8
1940	430	191	621	22.2	-6.2	22.7
1941	564	224	788	26.9	-9.1	40.7
1942	700	289	989	25.5	4.5	92.1
1943	838	306	1,144	15.7	-9.3	74.0
1944	1,013	338	1,351	18.1	-4.2	-22.9
1945	1,051	416	1,467	8.6	-13.6	-3.0
1946	989	488	1,477	0.7	29.0	-3.2
1947	1,059	594	1,653	11.9	5.7	1.1
1948	1,106	663	1,679	1.6	13.4	7.5
1949	1,072	724	1,796	7.0	-4.5	8.0
1950	1,081	775	1,856	3.3	9.1	-10.2

of their liquidity rather than as an investment.

On the basis of the data in Table 7, it seems that the volume of currency in circulation increased by only about 21 per cent between 1933 and 1938, in the line with the conservative policies followed by the government. The rise in bank deposits was steeper, however, as the banking system expanded, and this produced a fairly significantly increase in the total money stock. The signs are that there was no marked inflationary trend during the 1930s. Most of the rise in money supply seems to have

been absorbed by increased output of goods and services, shown by the trend of GNP at constant prices. Money supply and prices shown in Table 7 .

A significant development occurred in 1930 with the establishment of a Central Bank, which began operations in 1931. The most important function of the bank was its takeover of the note issue. The other functions of the bank were to act as the government's fiscal agent, to rediscount commercial and agricultural bills, fixing discount and interest rates, to make advances to the treasury, and to carry out controls on foreign currency. In 1938 the Central Bank was authorized to make advances on bills issued by the state economic enterprises and guaranteed by the Treasury, and to issue supplementary paper money accordingly. These new functions substantially increased the government's ability to resort to deficit financing, and had a crucial effect during subsequent years.

The relatively stable monetary conditions of the 1930s were drastically reversed during the following decade. In particular, the ever-present risk of invasion during 1939-46 forced the government to mobilize the armed forces and to increase its defense spending dramatically.

### **5. Foreign Trade**

As the figures in Table 8 show, the consistent deficit in the balance of visible trade which Turkey had experienced during the 1920s was reversed during the following decade, to produce a surplus for all years except 1938. Although the volume of exports increased substantially during the first half of the 1930s, the decline in commodity prices and the consequent worsening of the terms of trade pushed down the value of exports between 1930 and 1933, with a moderate recovery thereafter. Invisible imports and capital movements reduced these surpluses, so that the overall balance of payments may well have shown a deficit for some years.

World war II brought important changes to Turkey's international trading position. On the one hand, the belligerents bid up raw material prices, with a subsequent improvement in her terms of trade during 1944-49. Although the volume exports dropped well below pre-war levels, the annual value remained fairly steady during 1939-41, and then rose markedly during 1942-45. On the other hand, imports were restricted by the inability of the industrialized powers to supply goods which they urgently needed for their own war effort. The volume as well as the value of imports dropped sharply in 1940-41; there was some recovery, in value terms, during the remaining war years, but Turkey was still left with a healthy trading surplus. These

TABLE 8  
BALANCE OF VISIBLE TRADE, (MILLION \$ US)

Years	Imports	Exports	Deficit/ surplus	Deficit/ surplus as % of total trade	Nominal value of \$ in TL
1930	69.5	71.4	1.8	1.3	2.12
1931	59.9	60.2	0.3	0.3	2.11
1932	40.7	48.0	7.3	8.1	2.11
1933	45.1	58.0	13.0	12.5	1.66
1935	70.6	76.2	5.6	3.8	1.26
1938	118.9	115.0	-3.9	-1.7	1.26
1941	55.3	91.1	35.7	24.4	1.31
1944	126.2	177.9	51.7	17.0	1.31
1947	244.6	223.3	-21.3	-4.6	2.80
1950	295.7	263.4	-22.2	-4.0	2.80

conditions continued into 1946, so that, by the end of the that year, she had build up her gold and foreign exchange reserves to around \$262 Million. [Ref. 8: p. 159]

### C. UNPLANNED DEVELOPMENT OR THE DEMOCRAT DECADE (1950-1960)

When the Democrat Party stepped into power in Ankara in 1950, there were high hopes that Turkey had entered a brave and bright new era. They were believing in incentives rather than directives as the driving force of national progress. In practical terms, they were determined to devote more attention to the problems of the neglected but electorally important agricultural sector and to encourage private industry at the expense, if necessary of state enterprises.

The first four years of the decade, economic growth was high and satisfaction general. By the mid-1950s, production grew at a more modest rate and inflation began to eat into real incomes.

#### 1. Industrial Policy

A crucial area of policy, as always, was the relative weight to be attached to the state and private sectors in industrial development. In his government programme of 1951 Menderes declared that state undertakings other than those engaged 'solely in fields related to basic industries and having a public character' should be turn over to

private firms. And very little of the state's economic enterprises were actually transferred to private hands.

Private industry was dominated by individual entrepreneurs who were generally unaccustomed to managing the relatively large plants which made up the state sector. Although some of the SEEs could make respectable profits, there was absolutely no incentive for private capital to take over such loss-making operations as the state-owned coal mines or steel industry.

TABLE 9  
CAPITAL FORMATION, EMPLOYMENT AND VALUE ADDED  
IN MANUFACTURING INDUSTRY, 1950-58

Years		No. of establ.	Fixed capital formation, as % of Total	No. of workers	Value added as % of total
1950	State	103	54.4	76,033	58.3
	Private	2,515	45.6	86,826	41.7
1952	State	115	46.6	82,115	61.3
	Private	2,913	53.4	99,741	38.7
1954	State	146	59.4	86,161	50.5
	Private	3,704	40.6	130,960	49.5
1956	State	169	61.1	105,520	47.0
	Private	4,443	38.9	136,058	53.0
1958	State	195	57.0	117,852	45.0
	Private	4,026	43.0	172,869	55.0

The overall growth of the state and private sectors in manufacturing industry during the 1950s is shown in Table 9, the number of private firms was consistently many times that of the state undertakings. The employment they provided was also higher. On the other hand, the share of each sector in capital formation and value added fluctuated during the decade. As the new plants built by the private sector in the early 1950s began to come on stream, their share in value added in manufacturing industry rose. During the first four years of the decade, agricultural production boomed, increasing the overall level of economic activity, foreign exchange was freely

available for the import of industrial inputs, and the rate of inflation was kept at a relatively low level. In these conditions, private businessmen increased their investment and played their part in generating a sharp rise in industrial output.

After 1954 however, there was a serious deterioration. Agricultural production flagged, inflation rose to high levels, and there was a chronic shortage of foreign exchange on which industry depended for some raw materials as well as new equipment.

## **2. Agricultural Policies**

There were two principal planks in the Democrats' agricultural platform: first, an increase in the supply of credit and the maintenance of high minimum prices by state purchasing agencies, so as to boost the resources available to the farmer, and secondly, a massive increase in the import of tractors so as to extend the cultivated area, and thus raise production.

Total loans extended by the Agricultural Bank and credit and marketing cooperatives rose from TL 810 Million in 1950 to reach TL 2,856 Million by 1955 and TL 4,756 Million by 1960. The overall index of prices paid by the Office of Soil Products for wheat, barley, rye and oats rose from a base of 100 in 1950 to 120 by 1954 and 196 by 1959. Although these rises were at, or some what below, rises in the general whole sale price index, they were well above those of export prices for the same products. Moreover, the Office of Soil Products made a loss for every year between 1950 and 1960, except for 1952. Office's purchase prices exceeded export prices by a ratio of 1.5:1 in 1954 and 1.9:1 in 1959. Overall, public investment in agriculture rose, as a proportion of total public sector investments, from 15.4 per cent in 1950 to 27.9 per cent by 1959. [Ref. 7: p. 198] Granted that these developments were accompanied by a substantial rise in the volume of production during the early 1950s, it is not surprising that there was a sharp increase in the cash resources of farmers.

Peasants used their extra resources, in particular, for the purchase of tractors. Turkey still had a good deal of cultivable but unused land after World War II, and that there was a severe shortage of draft power in relation to land and farm labour [Ref. 9: p. 70]. Tractors were thus an appropriate and highly productive investment.

## **3. Labor and Social Policy**

The 1950s were years of heavy population growth, as well as rural urban migration. This is reflected in the changing structure of the workforce shown in Table 10 . With the 1950 census, statistics also began to be gathered on the breakdown of

the workforce by employment status. The results of these returns appear in Table 10. There appears to have been a predictable shift towards wage employment, away from unpaid work in family units, which is the traditional employment pattern on the peasant farm.

**TABLE 10**  
**ECONOMICALLY ACTIVE POPULATION, BY SECTOR, 1950-1960**

	1950	1960
Employment by sector	%	%
Agriculture	85.7	74.9
Services	6.9	10.2
Industry	7.4	9.6
Unknown	-	5.0
Wage earners	10.7	18.8
Employers	10.7	18.8
Unpaid family workers	62.9	47.9
Unknown	-	3.8

In the educational sphere, there was a steady rise in registration at all levels of education. In comparison with the previous fifteen-year period, in which the proportion appear to have remained fairly constant (See Table 5).

#### **4. Monetary and Fiscal Policy**

For purposes of comparison with the previous and subsequent periods, Table 11 defines the money supply as the total of currency and bank deposits of all kinds.

The exact relationship between increases in the stock of money and rises in the price level in Turkey has been the subject of a great deal of highly technical discussion. As the Table 11 indicates, however, the data from the 1950s suggest a rough but not exact link between increases in the money supply, the output of goods and services and the price level. During 1950-55 the stock of money increased by around 20 per cent per year. For the first three years, there was a steady increase in output to soak up the extra supply of money, and inflation was held at the comparatively low level of 3-7 per cent per year. In 1954 output fell mainly due to the disastrously poor harvest. The money supply continued to increase at around its previous rate, and inflation rose to about 12 per cent per year. During 1955-60 the

TABLE 11  
MONEY SUPPLY AND PRICES, 1950-60 (TL MILLIONS)

Years	Currency	Bank deposits	Total 1+2	%Rise in 3	%Rise in GNP	%Rise in prices
1950	1081	775	1856	-	-	-
1951	1200	994	2194	18.2	12.8	3.0
1952	1381	1255	2636	20.1	12.0	6.8
1953	1555	1610	3165	20.0	11.2	6.3
1954	1738	2025	3763	18.9	-2.9	12.0
1955	2061	2454	4515	20.0	7.9	9.9
1956	2533	3030	5563	23.2	3.1	13.2
1957	3310	3837	7147	28.5	7.8	19.6
1958	4056	4519	8575	20.0	4.5	11.8
1959	4261	5199	9460	10.3	4.0	18.8
1960	4997	5858	10855	14.7	3.4	3.9

growth in output was, in general, well below that of 1950-53. On the other hand, the growth rate of the money supply increased during 1955-57, with a rise in the inflation rate to just under 20 per cent by 1957. In 1958 government was forced to apply the monetary brakes, and the rate of increase of the money supply was accordingly reduced. Inflation nevertheless continued at a fast pace until 1960.

#### 5. Foreign Trade

During 1950-53 there was a steady rise in Turkey's exports, but this was accompanied by a still sharper rise in the imports bill, so that a large deficit on the current account developed in 1952-53. At the same time, inflow of foreign aid also fell away; the overall balance was only maintained by a reduction of reserves and increase in short-term suppliers and commercial credits. To make matters worse, exports fell back fairly sharply during 1954-58 and failed to recover their 1953 level for the rest of the decade. Imports, too, were reduced, but the current account was still heavily in the red, and Turkey was faced with a mounting total of foreign debt. In the last two years of 1950s there was some recovery in exports; imports nevertheless continued at a high level. Turkey's foreign trade exhibited constant ups downs during the period.

There are a number of factors which help to explain the foreign-trade fluctuations of the 1950s. During 1950-53, exports were aided by the surge in



agricultural production and in the supply of export goods. On the other hand , the decline in the value of exports after 1953 cannot be fully accounted for by factors beyond the control of the Turkish government, such as bad weather or a slackening of world demand. [Ref. 10: p. 43]

By the end of 1957, Turkey's external deficits had reached crisis proportions. The total foreign debt had reached \$ 1,011 million or about three times the 1957 export earnings while foreign-debt repayments were running at over \$ 80 million per year.

Plans for a general devaluation prepared and the effective exchange rates were raised, the external debt was consolidated and rescheduled and large credits from international lenders were arranged. Government also, undertook to abandon the resort to suppliers' credits, to restrict commercial and government budgets, to raise the prices of SEE products and to remove the price controls introduced in 1954.

### III. GENERAL OBJECTIVES OF THE DEVELOPMENT PLANS

#### A. ANALYTICAL FRAMEWORK OF PLANNING

Turkish plans can be suitably classified in accordance with their time coverage and the level of aggregation. With regard to the time coverage, they are divided into perspective plans, five-year plans, and annual programs. Respective plans specify the long-term economic and social objectives in broad terms. These objectives are turned into detailed quantitative targets through five-year plans which are implemented by means of annual programs.

With regard to the level of aggregation they prepared in three levels of aggregation. In the macrophase the focus of attention is on the estimation of alternative investment and saving rates (domestic and foreign) required for the realization of the prescribed growth rates of GNP. In the middlephase the level of aggregation is lowered to sectors. Sectoral composition of the desired level of GNP is specified and the consistent sectoral production and investment targets as well as required primary inputs are projected. The microphase is concerned with the selection of investment project to direct the economy into the desired path specified in the previous two stages. This "three-stages" approach was somewhat modified after the First Five-Year Plan (1963-67) by the integration of macro and sector stages within static input-output models. Ideally all these plans should be integrated analytically in a comprehensive planning system. [Ref. 11: p. 408]

##### 1. Perspective Plans

Effective medium and short-term planning in Turkey necessitates the guidance of a long-term plan in the following strategic questions.

##### *a. Trade*

What is the role of the trade in Turkish economic development? What are the lines of production in which Turkey can have dynamic comparative advantage? What would be the time phase of and policies for reorienting the economy from inward-looking to outward-looking strategies?

##### *b. Technology*

What is the expected role of technology in Turkish economic development? What would be the appropriate technology? What should be the strategy of the transfer of technology and speed of establishing a technological sector?

*c. Product mix and ownership*

What is the best composition of production chosen in accordance with the trade choices and available natural resources, and with their scale and technological advantages? What is the satisfactory pattern of distribution of ownership between public and private sector?

*d. Finance of development*

What would be the costs and benefits of the various sources of finance through time? What is the optimum combination of these three sources?

*e. Distribution of the burden and the fruits of development*

What is the long-term relationship between growth and equity? What are the policies to achieve both growth and equity?

All these issues are interrelated. Planned objectives related them should be set on the basis of a careful analysis of the human, natural, and technological possibilities in the economy. Consistency and feasibility of these objectives and the trade-off among them should be made within a formal macroeconomic framework. Totally of these efforts and decisions is the essence of a perspective plan.

The First Perspective Plan (FPP) which was introduced in 1963 laid forth the following targets to be achieved in the sequent 15 years:

- a. Training a sufficient number of high level personnel in all fields required for development,
- b. Achieving a 7 per cent rate,
- c. Solving the unemployment problem,
- d. Reaching a balance in external payments,
- e. Realesing these targets according to the principles of social justice.

These targets of the FPP which served as the guidelines for the First and Second Five-Year Plans (1963-67, 1968-72). These objectives are, in fact, too general to be useful.

In 1970 the Annex Protocol was signed with the European Economic Community (EEC) to determine the conditions of the transition period to full membership. To reflect these conditions on the plans the last 5-year segment (1973-77) of the FPP was abandoned and a new perspective plan (NPP) was prepared for 1973-95. The characteristics of the NPP was shaped by Turkey's expected integration with the EEC. The basic objective to be reached by 1995, when Turkey expects to be a full member of the EEC, is to raise the per capita income to the level prevailing in the

least developed country in the EEC in 1970 (Italy) through accelerated industrialization while decreasing dependence on foreign capital. The other objectives were similar to those of the FPP, except the rate of growth of GNP which was specified as 9 per cent in the New Perspective Plan (NPP) [Ref. 11: p. 410].

The principal concern of the NPP is the expected integration of Turkey with the EEC by 1995. At the end of the Third Five-Year Plan (1973-77) which is the first segment of the NPP, Turkey faces a dramatic economic crisis stemming from severe balance of payments difficulties and the relations with the EEC are planned to be "frozen" in the Fourth Five-Year Plan (1979-83), the second segment of the NPP.

## **2. Five-Year Plans**

The emergence in 1950 of a new political leadership in response to the grievances of private sector in general and agriculture in particular was associated with several important changes in development policy. The active encouragement of domestic and foreign private enterprise, the employment of an inflationary development strategy, the recourse to foreign indebtedness on a large scale in the face of growing deficits in the balance of payments, and the shift in the allocation of resources in favour of infrastructural investments in agriculture and communications which distinguished the economic policy of this decade did not, however, alter the basic development pattern of the encouragement of domestic industry through protection. [Ref. 12: p. 411]

The introduction of comprehensive planning in the early 1960s gave a substantial impetus to this industrialization pattern and initiated a major attempt at extending import-substitution into the intermediate and capital goods categories under successive five-year plans. In the first place, a 15-year perspective plan comprising the first three five-year plans for implementation during the 1963-1977 period was drawn, envisaging rapid growth in GNP and employment, internal and external financial stability, and a more equal distribution of interpersonal and interregional incomes. For the realization of rapid growth, main emphasis was once again put on industrialization as the overriding objective of economic policy. This was evident from the macroeconomic targets of both the First Five-Year Plan (1963-67) and the Second Five-Year Plan (1968-72) which, by way of diverting a large portion of total investable resources into industry envisaged for other sectors. The First Five-Year Plan, for example, aimed at an annual rate of growth of 12.9 per cent for industry (11.5 per cent for manufacturing) as against 7.0 per cent and 4.2 per cent for GNP and agriculture,

respectively. Although there were also several attempts at export-promotion, import-substitution through protectionist industrial growth. Whereas protection and import-substitution that followed from it in the 1950s had been very much a by product of import restrictions imposed in response to difficulties in the balance of payments, import-substitution through protectionist policies became an integral part of the planning process and emerged as a more direct and deliberate instrument of industrialization policy. Policies towards the private and public sectors during this period, on the other hand, were guided increasingly within the framework of a 'mixed economy' based on more balanced treatment of the two sectors in major fields of economic policy [Ref. 12: p. 412].

By the time the third five-year plan was (1973-77) being drawn up, State Planning Office (SPO) had acquired considerable experience and had also accumulated a much more satisfactory data base than had been available the first and second plans were being prepared. Unlike the first and second plans, however, the third plan does appear to have set an industrial priority: emphasis was to be on the development of heavy and defence industry. Naturally, such an emphasis implied continuing reliance upon import substitution. The relative importance of production of intermediate goods had increased steadily over the first two plan periods; and continuation of the industrialization thrust.

In response to inquiries about the origins of the emphasis on heavy industries in the third five-year plan, several explanations were given. One was new industries not developed by the time Turkey was scheduled to enter EEC. A second was that the sectoral targets resulted from the techniques used in plan preparation. Yet another explanation was that the government in power wanted emphasis placed on heavy industry, with its associated commitment to develop defence industries.

Alternatives were prepared for growth rates of 6.9-9 per cent [Ref. 2: p. 146]. A higher target for the rate of growth naturally implies a higher savings rate and more public investment; in addition, it requires a higher rate of industrial growth, and hence more import substitution and more heavy industry. The final decision between alternatives was based on the difference in implied taxation, foreign aid and savings targets, and the implied emphasis on heavy industry was not a factor in the choice. Ultimately, the decision was made to adopt as a target a 7.9 per cent annual rate of growth of GNP.

The unfavourable external environment which characterized the period after 1973 was largely instrumental in shifting the emphasis of the debate on Turkish growth and development once again to the external factors and removing further from the agenda the reassessment of the system of protection with a view of giving the economy an outward-looking orientation. Although the Fourth Five-Year Plan (1979-1983) drawn up in the midst of this crisis preserved much of the long-term commitment of Turkish planning to rapid growth through import-substituting industrialization and envisaged an average annual rate of growth of 8 per cent for GNP,<sup>1</sup> Turkey in both 1978 and 1979 became preoccupied with short-term stabilization which addressed itself, in the first place, to controlling inflation and the provision of external assistance oil and other essential imports. As a result, economic policy-making became increasingly vulnerable to and indeed interwoven with external finance prospects with the IMF and other financial media reaction to Turkish letters of intent having a greater impact in this respect than the objectives and mechanism of central planning as the realization of plan targets itself required right at the outset international financial backing in terms of both debt-rescheduling and provision of fresh facilities.

The social-democratic government's attempts at economic stabilization in 1978-1979 could not prevent the emergence of severely negative rates of interest, a highly overvalued domestic currency, widespread shortages of imported materials. After the election in November 1979, the new government's first major task was the introduction in January 1980 of a Stabilization Program under IMF auspices which received immediate recognition and support from international organizations like the World Bank and the Organization For Economic Cooperation and Development (OECD).

The military take-over of September 1980 was a crucial event for the Stabilization Program. The military government's adherence to the Stabilization Program and keeping the economic team associated with the program in charge gave a major boost to it and enabled its continued enforcement during the full course of military rule which ended following the general elections of November 1983.

The new government, in the first few months after coming to office, introduced a major set of economic policies the main elements of which came straight from its election manifesto. While the December 1983-January 1984 measures again contained a wide range of policies pertaining to interest rates, prices of state economic

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<sup>1</sup>The target rates of sectoral growth were 5.3% for agriculture, 9.9% for industry, and 8.5% for services.

enterprises, and various other fiscal and monetary measures, by far the most significant elements in these measures was the radical shift in policies vis-a-vis foreign trade and payments with a view of liberalization and giving the economy an increased export orientation.

The Fifth Five-Year Plan which was introduced in 1984 laid forth [Ref. 13: p. 407] the following targets to be achieved in the subsequent five years:

- a. Elimination of disequilibria in major markets and breaking the inflationary spiral,
- b. Coping with the immediate pressures on the balance of payments,
- c. Reduction of inflation and attainment of price stability,
- d. Privatization of economic life and,
- e. Liberalization of foreign trade and payments as a part of efforts to shift to an export-oriented industrialization strategy and attain a sustainable balance of payments position [Ref. 14: p. 276].

### 3. Annual Programs

Annual programs constitute the most important part of the planning approach adopted in Turkey [Ref. 11: p. 418]. This is because it is through annual programs that the plans are implemented, on the one hand, and are revised and adjusted in the light of the past performance and changed circumstances, on the other.

Both five-year and perspective plans specify government intentions. Annual programs, on the other hand, have the task of presenting the policy measures and legislation required for implementing the yearly parts of five-year targets. They are drawn up in conjunction with the government budget, and together they form an obligation on the government to implement the specified policies. For successful implementation annual programs should be instrument-specific. They also provide an opportunity to review and revise the five-year plans on the basis of past implementation and changed circumstances.

The annual programs cover both the public and private sectors. However, whereas the plans have made very little distinction, at least within industry between public and private activities, there are sharp differences in the way the two sectors are treated.

First, however, the manner in which the annual investments for each industry are determined, and then allocated between the public and private sectors, must be indicated. When investment levels and targets for the following year are planned, the first step to compare the record of the industry's investment and output performance

with plan targets. The actual output and investment figures and figures contained in the plan are converted into a common price unit by converting the plan targets into prices of the most recent year for which data are available. In the process, minor changes are often made in plan targets, as past performance provides of the plan were wide of the mark.

When past performance in a particular sector is well ahead of the planned levels, investment targets for the following year are generally trimmed back, although not to such a level that no investment would be forthcoming. The converse also happens when investment is lagging behind plan targets. In such circumstances, there are numerous ways to stimulate investment. [Ref. 2: p. 148]

SPO also conducts an annual survey of industries in the private sector,, designed to provide estimates of private-sector investments planned for the following year. The evaluation of past performance in contrast with the plan and the modified plan targets are combined to provide initial estimates of private and total investment by sector.



## IV. THE DEVELOPMENT OF STATE ECONOMIC ENTERPRISES

### A. BACKGROUND

Among the developing countries, Turkey is unusual in several regards: the modern nation-state emerged in 1923, and efforts to achieve higher living standards precede those of most developing countries by a generations; early development policy, in the 1930s, concentrated upon the formation of State Economic Enterprises (SEEs), which continue to play an important part in manufacturing industries, thus giving the public sector a more significant role than in most non-centralized economies.

TABLE 12  
FOUNDING DATES OF ALL PUBLIC ENTERPRISES  
ESTABLISHED AS OF 1960

Years	Percent of Total
Before 1923	97.6
1923-1939	83.8
1940-1945	81.6
1946-1960	40.3

As can be seen from the Table 12, the transition to private sector greatly accelerated during the 1950s [Ref. 15: p. 59].

The main practical expression of the etatist (statist) philosophy was Turkey's first five-year industrialization plan, which was drawn up in 1933 and put into operation between 1934 and 1938. The plan provided for the establishment of a series of industrial plants designed to reduce Turkey's needs for imported consumer and intermediate goods using domestic raw materials. State agencies were to be responsible for financing, constructing and managing these plants. The main industries affected were the manufacture of cotton and wool textiles, paper, ceramics, glass, cement and some chemical products, besides iron and steel.

Two new development banks were established to finance and control the expanding state industrial sector during the 1930s. The first of these, Sumerbank, was set up in 1933 with a nominal capital of TL 20 million, increased in successive stages to TL 200 million by 1946. Sumerbank took over the factories formerly run by the Bank for Industry and Mining, to which were added the majority of the new plants established under plan. Apart from those undertakings over which it had control, Sumerbank also continued its predecessor's policy of investing part of its funds in private enterprises, in such field as textiles, sugar, power generation, ceramics and sulphur.

In 1935 a second state agency, Etibank, was established, with primary responsibility for the mining industry. Etibank's main activity was in the Zonguldak coal field, where it took over operations from the former French concessionary company in 1936. Apart from this, Etibank acquired total responsibility for the mining of iron ore and copper, competing with private enterprises in the production of lignite and chromite. Etibank was also nominally responsible for government-owned power installations: in fact, there was no national grid, and just under half the power generated came from municipally-owned plants.

The initial capital of Sumerbank and Etibank was subscribed by the government, or inherited in the form of assets from predecessor organizations. Subsequently, they derived their funds from further direct allocations from the budget, from government loans, in the form of advances from the Central Bank on Treasury-guaranteed bills and from ploughed-back profits. From the beginning, they had also operated as commercial banks, opening branches and accepting deposits from the public [Ref. 5: p. 57]. However, as time went on, these deposits represented a shrinking proportion of their total capital and liabilities. In other words, both organizations acted as state-owned holding companies with minor banking functions, rather than state-controlled banks.

The undertakings owned by the state banks -Sumerbank, Etibank and Agricultural Bank- had independent status. Their revenues were not turned over the treasury, and their expenditures were not included in the annexed budget. Their overall direction was entrusted to a General Economic Commission, chaired by the Prime Minister and including representatives of the economic ministries, members of special committees of the National Assembly and the directors of state and other banks.

Originally the SEEs were supposed to operate with a high degree of autonomy and to strive for profits as a private business would have done. In fact, the degree of political interference which the administrative system provided for meant that the practice fell well short of the ideal, and that the SEEs became prey to inefficiency, excessive red tape, and the demands of political patronage. Inevitably, their staff became demoralized.

Etatism was, by its nature, bound to give the state sector an increased role in industrial development. State Enterprises could borrow from the Central Bank at an interest rate of 1 per cent: Private entrepreneurs seem to have relied on ploughed-back profits or the sale of other assets for their industrial capital but, if they did turn to the commercial banks, they could expect to pay 8.5-12 per cent annual interest. With its easier access to capital the state tended to own the largest and most modern plants and should have had a competitive advantage.

By 1939, and in spite of the expansion of the Sumerbank industries, private firms still accounted for about 65 and 40 per cent respectively of the output of cotton and wool products, 38 per cent of leather and 45 per cent of cement. Only in the cases of artificial silk, paper, iron and superphosphates did the state have a virtual monopoly. Total gross investment during 1933-39 probably amounted to about 9-10 per cent of GNP: of this, the private sector appears to have accounted for about 50-65 per cent.

It was only during World War II that the government took stringent measures to control the private as well as the state sector of the economy. Whatever her pre-war policies, Turkey, like other countries, was virtually compelled to introduce a new range of economic controls. In the process, the state sector increased its share of industrial output, at the expense of that of private industrialists. Production by the SEEs increased by around 49 per cent between 1939 and 1945, whereas that of the mechanized private sector rose by only 7 per cent.

The only important new plant initiated during the second plan period was the iron and steel mill at Karabuk, which had been provided for in the first plan, but didn't begin production until the end of 1939. Although some new plants were opened during the war, they mainly sufficed to expand the industries established under the first plan.

The state's most important intervention in agriculture during the 1930s was in the field of price support. There was no national bufferstock scheme, to even out the climatically- induced fluctuations in crop output from year to year. The government attempted to tackle this problem in 1932, when a division of the Agricultural Bank was

authorized to buy and sell wheat -if necessary at a loss- and, later to built grain silos. In 1938 this function was transferred to an Office of Soil Products (OSP), a state economic enterprise attached to the Ministry of Economy. Apart from engaging in domestic trading and storage, OSP also acquired a monopoly of grain importing and exporting.

The planning and management of the state economic enterprises in the 1950s continued most of the defects inherited from the previous period. They may be summarized as, first, a system of pricing which bore little relation to costs, and a consequent resort to inflationary deficit financing; secondly a tendency to establish new plants for purely political reasons, with little regard to locational advantages or the needs of the market and, thirdly, continued political interference and stifling red tape in day-to-day administration.

On the first score, the SEEs were stated by law to be 'free to fix the prices of goods and services'. The law added ominously that 'of these goods and services, the prices and of basic goods and services may, if necessary, be fixed by the Council of Ministers'. The result was that prices of many SEE products were arbitrarily established, normally at a low level, so as to reduce costs for domestic consumers. As an example, the maximum prices for such SEE products as sugar and cement were frequently below production costs, after taxes had been allowed for. These losses, as well as funds for new investment, were made up by credits from the Central Bank, a practice established in earlier years. Such credits rose from a total TL 770 million in 1950 to TL 3,247 million by 1958. In that year, as part of the stabilization programme which was forced on the government by the International Monetary Fund (IMF), the prices of SEE products were increased. This initial round of increases proved insufficient, so a further round of price hikes was decreed in 1959. The rate of increase of Central Bank credits was accordingly reduced during 1958-60; nevertheless the total, which included the debts of the Office of Soil Products, had still risen to TL 3,811 million by the end of the latter year.

Secondly, badly planned and located plants abounded in the 1950s. The democrats were prepared to established factories in politically sensitive areas, even if the production costs were unnecessarily high, or there was no demand for their products. To keep the plants operating at near capacity, Turkey was forced to dump product, at a loss, on foreign markets during 1959-60.

Thirdly, management inefficiency and frequent political interference was, as in earlier years, a constant source of complaint. The High Control Board which supposedly had wide powers over the SEEs was in fact ineffective. In practice day-to-day responsibility was exercised by the minister to whose ministry the enterprise was attached, who could use his extensive powers of appointment to political advantage. Thus combined with the constraints of the fixed salary scale to produce a high rate of turnover among senior staff. [Ref. 7: p. 314]

Taking these factors together, and remembering that the state accounted for a higher proportion of new investment during the latter part of the decade, it is not surprising that, in effect, Turkish industry became less efficient as the 1950s progressed. In particular, the marginal capital-output ratio rose from an average of 1.96:1 for 1951-53 to 4.56: for 1955-60 [Ref. 5: p. 93]. The excessive growth of the state sector also helps to explain why the annual rate of production increase some industries- notably sugar and cement- was higher during the second half of the decade, although that of industry as a whole was markedly lower.

The assumption that the state sector had the major responsibility for industrialization was questioned during the late 1940s. The period of the first two five-year plans saw a distinct switch of official emphasis on the role of the state in industrial development (see Table 12). Since the late 1960s a good deal for the heat seems to have gone out about etatism. Both Justice and Republican People's Parties now accept the existence of an important state sector in consumer goods industries, as well as heavy industry and public utilities. The third and fourth five year plans concentrate on the need to improve the efficiency of existing state enterprises, rather than urge the reduction or increase of the state's industrial role. For its part, the RPP has conjured up the vision of a people's sector owned by its workers or cooperatives. The fourth five-year plan (1979-83) deals at some length with the prospect of 'broadly based people's entrepreneurship', but admits that little has been achieved in this direction.

On the investment side, the state sector's share of total fixed capital investment actually rose during the second-plan period,inspite of the Justice Party's declared emphasis on private sector development. In the period of Third plan, however, the balance between the two sectors remained relatively unchanged. At the same time, the second and third plan periods saw a significant increase in the private sector's share of value added in manufacturing. In the 1970s, when comparing output and employment of the public and private sectors, the state sector share of total employment in

manufacturing industry is slightly lower than its share of total output, in some other industries, this position is reversed.

TABLE 13  
PUBLIC SECTOR SHARES IN MANUFACTURING  
INDUSTRY, 1979 (PERCENT)

Industry	Production	Value Added	Employment
Processed food	37	39	50
Beverages	40	43	46
Tobacco	91	93	94
Textiles	12	13	20
Wearing Apparel	15	22	15
Leather	20	-	24
Wood	31	34	41
Furniture	12	17	16
Paper/P. Products	60	43	69
Printing/Publishing	10	17	23
Chemicals	23	25	29
Petroleum	87	75	76
Rubber and Products	1	1	0
Non-metallic minerals	18	15	20
Basic Metals	46	46	67
Metal products	11	16	7
Machinery	21	26	28
Electrical machinery	2	3	7
Transport equipment	14	29	41
Other	8	10	12
TOTAL	32	30	36

The share of the public sector in manufacturing employment in the 1970s remained virtually constant at about 36 percent. Meanwhile, its share in value added declined, from 51 percent in 1970 to 41 percent in 1975 and 30 percent in 1979. Table 13 shows the relative shares of the public sector in production, value added and employment in individual industries in 1979. The public sector accounted for more than half of output in tobacco (91 per cent), petroleum (87 per cent), paper and paper products (60 per cent), and printing and publishing (57 per cent). Their share is also

high in basic metals (46 per cent) and beverages (40 per cent). At a more disaggregated level, the public sector controls almost all production of steel and alcoholic beverages and more than half of cement, fertilizers and sugar. In turn, there is competition with private enterprises in textiles, apparel, leather products, and machinery and transport equipment.

Eight enterprises established under Law 440 account for almost all economic activity of State Economic Enterprise in manufacturing. These are the Turkish Sugar Corporation, Sumerbank (which produces largely textiles), the Pulp and Paper Corporation (SEKA), the Petrochemical Corporation (PETKIM), the Nitrogen Industry Corporation, the Turkish Cement Corporation, the Turkish Iron and Steel Corporation and the Machinery and Chemicals Corporation (MKEK). Most of these enterprises come under surveillance of the Ministry of Industry and Technology. At the same time, the share of the public sector in fixed investment in manufacturing rose, from 39 percent in 1972 through 1974, to 47 percent in 1976 through 1977, 50 percent in 1978 through 1979, and 60 percent in 1981 [Ref. 16: p. 248]. These trends give an indication of the rising relative capital intensity of public sector activity in manufacturing as well as of growing relative inefficiency, as rising capital intensity was not offset by declining labor intensity; in fact, the contrary is true, since the labor intensity of the public sector relative to that of the private sector has been rising in the 1970s.

## **B. INWARD ORIENTATION PERIOD**

Turkey maintained an inward-oriented stance during the 1960-1973 period. While this policy permitted attaining relatively high rates of economic growth for a time.

Turkey continued with inward orientation following the external shocks of the quadrupling of oil prices and the world recession while attempting to maintain its rate of economic growth. This proved temporary, however, as the policies applied aggravated the adverse balance-of-payments effects of external shocks by giving rise to reductions in export market shares and increases in import shares.

Under the policies applied, the deterioration of Turkish economic performance continued after 1973. This indicated by increases in incremental capital-output ratios that reflect the efficiency of using additional resources. With the rising cost of import substitution, the economy wide incremental capital ratios estimated from official data increased from 2.3 in 1963-67 to 2.6 in 1968-72 and, again, to 3.8 in 1973-77. The

increase was larger in the manufacturing sector, where inefficient import substitution was concentrated, from 1.6 in 1963-67 to 2.4 in 1968-72 and, finally to 4.7 in 1973-77.

Turkey was able to avoid a decline in the rate of economic growth by raising the share of gross fixed investment in GDP. This share increased from 16.0 per cent in 1963-67 to 18.0 per cent in 1968-72 and, again, 22.9 per cent in 1973-77. The rise in investment, in turn, was made possible in large part by the inflow of funds from abroad, first in the form of workers' remittances and, subsequently, through foreign loans. As a result of increased foreign borrowing, the ratio of debt service to merchandise exports rose from 13 per cent in 1973 to 33 per cent in 1977. At the same time, with the decline in export shares and increases in import shares, the Turkish economy did not generate the foreign exchange earnings (savings) that would have permitted it to reduce foreign indebtedness. With increasing foreign exchange stringency, there were considerably shortages of energy, raw materials, and spare parts in Turkey. As a result, industrial production fell by 5.6 per cent in 1979 and the gross national product also declined.

### **C. THE 1980-81 REFORMS**

It appears then that, rather than adjusting to the external shocks, the policies applied in Turkey after 1973 aggravated the situation. Employing the panoply of measures characteristic of inward-oriented economies, the policies applied included the overvaluation of the exchange rate, discrimination against exports, high and variable industrial protection, price control, as well as negative real interest rates.

The Turkish agriculture also suffered the disadvantages of price control, aimed at keeping consumer prices low, that was offset only in part by the low price of fertilizer. Price control extended to most products of State Economic Enterprises (SEEs) resulting in considerable losses for those enterprises that were financed from the government budget. The adjustments of the prices of commodities produced by the State Economic Enterprises at shorter intervals together with increasing reliance on economic criteria in the determination of agricultural support prices led to a considerable reduction in the recourse of SEEs and agricultural support agencies to Central Bank resources with Central Bank credits for agricultural support purposes in fact declining steadily during 1981-83 [Ref. 12: p. 280].

The January 1980 policy changes aimed at redressing the situation and changing the development strategy Turkey followed in the previous decades. They combined stabilization measures, with the twin objectives of reducing the rate of inflation and



improving the balance of payments, as well as reform measures, with a view to turning the Turkish economy in an outward direction and to giving an increased role to market forces. Stabilization objectives were pursued by reducing the rate of money creation. Both stabilization and reform objectives were served by a substantial devaluation that aimed at reducing the balance of payments deficit as well as improving the system of incentives. Import regulations were also streamlined in January 1980.

Industrial prices were also liberalized in January 1980, with increases ranging up to 300 per cent for paper and 400 per cent for fertilizer, thereby reducing the deficit of the SEEs to a considerable extent. With a few exceptions, the freedom of industrial prices has subsequently been maintained. The scope of central price determination has also been reduced in agriculture, and the prices of the remaining products subject to control have been annually adjusted. [Ref. 17: p. 441]

Changed exchange rate policy, import protection, and export subsidization would ensure continued progress towards outward orientation in the Turkish economy. The objectives of the January 1980 reform would further be served by reforming the operation of the state economic enterprises. The implementation of proposals made by the government to increase the decision-making power of managers, and to make them responsible to an independent general assembly, would represent important steps in SEEs reform. Additional step would need to be taken, however, in order to fully integrate the SEEs in the market economy.

## V. THE PROBLEMS OF THE STATE ECONOMIC ENTERPRISES

### A. THE EARLY PROBLEMS OF STATE ECONOMIC ENTERPRISES

The early operations of state economic enterprises infused new elements of managerial and technical change and probably accelerated the process of industrialization [Ref. 18: p. 56]. At the same time they were also associated with a series of problems. Some of these directly affected their performance while others had harmful indirect repercussions on the rest of the economy.

#### 1. General

The following were perhaps the main problems associated with the expansion of the public sector in the 1930s.

##### *a. Inflationary financing*

Industrial investments coupled with the purchase of railroads from foreign concessionaires led to some inflation. Much of the expansion of the state sector during the 1930s was financed by charging relatively high prices to consumers, by borrowing from the Central Bank, and by drawing short-term advances from the State Treasury.

##### *b. Problems of planning, personnel, finance, and control*

Several production units were created in advance of an actual market for their products, and most of the enterprises became heavily indebted to the Treasury. To attract personnel, the state economic enterprises paid much better salaries than the established government agencies. As a result, assignment to a state enterprise had a great attraction for many a state bureaucrat, quite apart from his suitability for such an assignment.

During the period of intense state industrial investments initiated under the first plan, action took precedence over the establishment of a precise institutional and legal framework to fit the new state industrial empire. In 1938, however, Law 3460 was enacted to govern the activities of all state companies. In 1964, the main principle of new Law 440: State economic enterprises had to be established by a special act of parliament, they would have legal entity, and each one of them would be related to a ministry whose function was to implement government policy in the area in which the state economic enterprise was operating [Ref. 19: p. 21].

The free-wheeling financial and personnel policies of the state enterprises. on account of which considerable graft may have occurred in the passing of huge contracts, brought out two offices, the Ministry of Finance and High Control Board, which were soon to curb their easy and dynamic ways [Ref. 5: p. 77].

*c. Price control*

Price controls theoretically work in a rigidly controlled framework, but they haven't been successful in free economies.

*d. Isolation*

The staggering financial costs coupled with the deteriorating international climate and the need to spend more money for defense were the principal factors that forced a halt in the expansion of state enterprise after the explosive outburst of the 1930s. Besides the individual enterprises had expanded so rapidly.

**2. Administration**

The administration of public enterprise has been studied countless times by experts. The subject has been analyzed and discussed in all the five-year plans, in the annual reports of the High Control Board, in Parliament, in the press, and in academic circles.

It is important, in fact, to separate fundamental problems from minor ones and symptoms -such as lack of an effective marketing organization, insufficient attention to research and development, or, in some enterprises, a poor financial structure- from the actual ailment.

*a. Political interference*

Areas of political interference explicitly recognized are collective bargaining and wage policy, price policy, and investment decisions -for example, project location, choice of technology- sources of procurement. Frequent changes in top management are also related to politics.

*b. Ambiguity about objectives coupled with shortcomings in accounting to the nation regarding results*

In state enterprises business functions are fused with public services, and no attempt at even rough separation is made in the accounting system. Neither is there any attempt to sort out the additional cost of politically dictated choices of location, technology, or source of procurement. Another significant weakness is the failure to distinguish between economic and commercial results. Failure to draw a distinction between two is the most obvious obstacle to making state economic enterprises truly accountable to the nation.

*c. Lack of direction and coordination at the top*

There is no top organization to coordinate investments by various public agencies and settle priorities efficiently. Every SEE is subject to control at four levels: the Ministry of Finance, the responsible ministry, the State Planning Organization (SPO), and the High Control Board (HCB). The SPO has taken an active hand in the initiation of large projects and follows up on their execution. The "related" ministries sometimes come up with project suggestions. Their main responsibilities with respect to SEEs, however, are to coordinate, control, and give direction to those that are within their sector, in accordance with the targets of the Five-Year Plan, to solve problems and resolve conflicts. The HCB is concerned essentially with auditing in a rather narrow sense; it takes long-run objectives as given. The Ministry of Finance receives the annual investment and financial programs of SEEs and, after consultation with the SPO, presents these to the Council of Ministries. By law, the Ministry of Finance has the largest share of responsibility for the financial administration of SEEs. Where there is a financial gap that cannot be covered by the State Investment Bank (SIB) according to development banking criteria, the Ministry of Finance must consider a variety of other measures, such as subsidies, increases in protective duties, increases in controlled prices, and additional equity or subordinated loans convertible to equity. A last important function of the Ministry of Finance is the negotiation of loans with international lending agencies. Apart from general diffusion of authority among the SPO, the Ministry of Finance, and the "related" ministry, there is also striking fragmentation of responsibility for the SEE among several ministries.

*d. Lack of proper staff incentives*

This applies particularly to top and middle management, and in conversations with staff at these levels, lack of incentive is frequently mentioned as the root cause of low efficiency in SEEs. The principal handicaps are lower pay than in the private sector, insecurity of tenure in the higher positions, and long delays before important decisions can be reached. The top executive, in addition, may have to defend his decisions and his strategy in endless discussions with full-time board members who often have little understanding of business in general and even less of the particular industry in which the firm is operating. Such conditions are a principal cause of high turnover among top-ranking personnel.

## **B. OBJECTIVES OF STATE ECONOMIC ENTERPRISES**

### **1. Specific Objectives for Individual Enterprises**

The role and strategy of state enterprise -development of basic industries and new industries of advanced technology, for example- has to be translated into specific individual enterprise objectives and investment decisions. Integrity in objectives is important in itself; it is also necessary for unambiguous measures of performance.

Several considerations must be taken into account in fixing the objectives of state enterprise in manufacturing.

#### ***a. Financial return***

The objective in a free economy with a little or no protection, where high profits are more or less synonymous with low costs. It is only a secondary objective in a highly protected or subsidized industrial economy. Nevertheless, it could be made a primary objective if subsidies or protection had been fixed beforehand in a purely objective manner to approximate external economies -through the creation of new skills, new supplier industries, or new infrastructure- nationally or with special reference to some underdeveloped region.

#### ***b. Economic return***

In the typical project of a large state manufacturing enterprise, however, a decision on huge investments is usually interlinked inextricably with decisions on incentives and protection. It then becomes necessary to evaluate the extent to which any subsidies received are compensated for by indirect economic benefits, or external economies- in other words, to calculate the economic returns on the investment. A high economic return becomes, in fact the primary objective.

#### ***c. Capital intensity and labor intensity***

State manufacturing projects tend to absorb huge financial resources and to be highly capital intensive. Yet most developing countries are faced with severe savings and balance-of-payments constraints. Hence, even though low ratios of capital to output and capital to employment might not be regarded as objectives in themselves. They are nevertheless subsidiary criteria by which the performance of the state sector might appropriately be judged. They are indicative of the sacrifices made by the country to achieve certain goals in output and employment and may be properly compared with hypothetical ratios under alternative development paths and investment strategies.

#### *d. Dynamic growth*

It must be expected that state enterprise in a developing country will be dynamic and that it will seize opportunities not open to private enterprise because of the size and risk of the investments required or perhaps because of special requirements of managerial and technical expertise.

### **C. PERFORMANCE OF STATE ECONOMIC ENTERPRISES**

The efficiency of an activity from an economic point of view is essentially an amalgam of the technical efficiency with which it is designed, built and operated, and its appropriateness to the conditions, especially factor supplies of the country. At the same time, financial performance can deviate from economic performance to the extent that market prices deviate from shadow prices. With some knowledge of these price deviations, inferences on economic efficiency can be drawn. Financial performance also has importance in its own terms, since it has implications for public finance. Technical, economic, and financial performance are all considered below.

The use of capital and labor per unit of output is a direct indicator of technical and economic efficiency. By 1976, the public sector's efficiency was below that of the private sector. The relative use of labor in the public sector per unit of output was higher than in the private sector in twelve of the fourteen industries, the only exceptions being beverages and petroleum and coal. The average ratio of output to labor in public sector plants is 48 per cent below that in private sector plants. A major reason for this result is the relatively small size of the public sector plants. If we control for differences in plant size, output per man seems to have been about 16 per cent lower in public than private plants with only a one in eight chance that the difference is statistically insignificant.

The overall financial performance of SEEs, their growing deficits and rising investment requirements, have been discussed in Chapter I. The financial performance was really bad. First, inflation adjustments were not made in the accounts, with the result that depreciation allowances greatly underestimate current replacement cost and profits on inventories are overstated. In the second place, interest rates paid were strongly negative in real terms. Finally, most price controls had been lifted, the uncontrolled prices were in many cases well above international levels. Yet, these uncontrolled prices were equated to production costs.

TABLE 14  
EXPORTS AND IMPORTS OF MAJOR  
STATE ECONOMIC ENTERPRISES, 1980 (US \$ MILLION)

Corporation	Imports		Total	Exports	Balance
	Production goods	Investment goods			
MKEK	4.8	6.0	10.8	4.1	-6.7
Sumerbank	10.3	42.9	53.2	19.8	-33.4
Turkish Cement	-	18.0	18.0	103.1	85.1
T.Iron /steel	66.8	40.7	107.5	2.3	-105.2
SEKA	26.5	44.9	71.4	-	-71.4
PETKIM	65.0	137.5	202.5	7.7	-194.8
Fertilizer	77.6	14.8	92.4	-	-92.4
Turkish Sugar	1.1	13.3	14.4	11.1	-3.3
Total	252.1	318.1	570.2	148.1	-422.1

One aspect of economic performance of importance to Turkey is the trade position of the SEEs. Table 14 shows the direct imports for operations and investment of eight major State Manufacturing Enterprises as well as their direct exports in 1980. The cement company was the only one to earn a surplus and accounts for 70 per cent of the total exports, sumerbank and the Sugar Corporation also had exports of some significance. Overall, the group ran a deficit of \$104 million on operations and \$422 million in total. Thus, the foreign exchange losses of these enterprises demanded offsetting surpluses elsewhere in the economy. It should be remembered in this context that these eight corporations, whose combined exports were only \$148 million, had absorbed about a third of all investment in manufacturing.

In summary, the SEEs play an important role in the development ideology of Turkey and in the actual development of the country. This is true both overall and in the manufacturing sector, in particular. There is a clear evidence that the manufacturing enterprises have been wasteful in use of resources. Similarly, financial performance has been poor. Price control might have been a partial explanation for poor financial performance in some enterprises but economic inefficiency is the main reason.

## **1. Causes of poor economic and technical performance**

Productivity and profitability require the rational use of inputs and continuous progress in adapting the outputs to the needs of consumer. The apparent reasons for low profitability and productivity are set forth below.

### ***a. Economic policy***

One reason for the economic inefficiency of many SEEs is the trade regime. In attempting to integrate backward into the production of the basic, capital-intensive intermediate goods like steel, chemicals, petrochemicals, paper, and non-ferrous metals, the planners have relied almost exclusively on state enterprises, new and old. While SEEs operate in other industries as well, they are strongly concentrated in the activities in which Turkey does not have a comparative advantage.

### ***b. Operating control***

The responsible Ministry co-ordinates the relationship of the enterprise with other branches of the government. The Ministry responsible also plays a dominant role in the selection of the Director General and two assistant Director Generals that make up half the Board of most state enterprises. In sum, the Ministry has very great direct and indirect leverage over the enterprises.

The formal system of control was also a vehicle for informal pressures from the party, from the responsible Minister, from the Prime Minister, or from elsewhere in government. Given the dependence of SEEs on government for finance and of their managers on support, if they were to maintain their jobs, informal pressures could clearly be of great importance.

### ***c. Investment planning***

The State Planning Organization (SPO) which comes under a High Planning Council (HPC) composed of four ministers, the undersecretary of SPO and the heads of three SPO departments, has the main responsibility for formulation of investment programs for industrialization.

The five year plans do not contain project detail, but the input-output analysis underlying them was used to identify likely opportunities and help appraise projects. These are proposed and agreed five year rolling investment plans. The ideas for individual projects may originate with the enterprises themselves, but this need not be so. The SPO may have its own notion of what is needed, or the Ministry responsible. The political process was particularly important in the creation of new enterprises.



Project evaluation by the State Planning Office involved six criteria:

- a. Value added per unit of capital,
- b. The labor-capital ratio,
- c. The foreign exchange implications of the investment,
- d. The nature of technology, economic size,
- e. The marketing aspects,
- f. The location.

The SPO suffered increasingly from shortages of skilled manpower, in part because of inadequate pay for them.

The evaluation of the feasibility and profitability of state enterprise investment by the State Investment Bank (SIB) would check the uncontrolled expansion that had characterized the period before 1964. Carrying out this task successfully was very limited. One reason is that was restricted to the finance of a subset of the investments already approved by the SPO in the context of annual programs. In addition, the enterprises concerned knew that funds would be provided from elsewhere, if necessary. An important point is that the Bank became much less important than expected as a source of finance.<sup>2</sup> SIB suffered from the same shortages of skilled staff as other agencies. In sum, SIB's influence was very limited, affecting largely the timing and design of projects rather than whether they would go ahead, and so was its capacity to finance and to evaluate projects.

Since investment projects are prepared based on multiple criteria, and since political and social concerns intervene, the selection of technology and location of investment cannot be effectively made and the priority of investments cannot be accurately determined. Therefore, scarce resources are wasted. Implementation of investment projects is delayed and, therefore, prices rise to an unpredictable level.

*d. Financial control*

In the late 1970s, as SEE performance deteriorated, the financial control mechanism was stretched between state enterprise losses, on the one hand, and, their investment, on the other, with the two moving in opposite directions. The Ministry of Finance, through its central role in the financial aspects of the Annual Program, bore the main responsibility for managing the situation. The conflict between growing losses and the required finance for investment was resolved by a compromise that

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<sup>2</sup>Early 1970s, about 60 per cent of SEE investments were self financed, with 20 per cent coming from SIB funds and 20 per cent from the general budget. By the late 1978 the SIB share was down to 10 per cent.

generated both accelerated inflation and wasted investment expenditures. The project delays must have further worsened the operating performance of SEE, thereby creating a vicious circle.

The State Economic Enterprises are not given sufficient fixed and working capital, considering the financial and technological burdens of investment imposed on them. The losses created by special duties assigned to them by the government are not compensated in time, and there is no top organization to coordinate the use of SEEs funds; hence, most enterprises are dependent on the General budget and other external sources. A balance of financial sources cannot be achieved, and dependable sources of finance are not available; hence the burden of interest becomes excessive. The accounting framework does not lend itself to administrative control nor does it incorporate an efficient budgeting system. Enterprises do not employ flexible policies. In many cases prices are determined without reference to market factors. And financial statements do not reflect the real assets of the enterprise.

*e. Auditing*

The High Control Board has had responsibility for audit of SEEs for over forty years. The report of the HCB is reviewed formally by a parliamentary commission of twelve and informally by a group consisting of representatives of the enterprise, the HCB, the SPO, the Ministry of Finance and the Ministry responsible. The HCB is not considered effective. There are two major problems: the lack of timeliness and the lack of publicity. HCB reports are both late and provide only partial coverage. Quiet apart from the availability of reports, the financial data were adequate, there was no explicit economic audit. In addition to the failure to adjust for inflation, SEE generally faced different prices for output, a different structure and level of employees' remuneration, a different cost of capital, and a different corporate tax rate from those facing private sector.

*f. Management and organization*

Employees under trade union contracts were successful in raising real wages especially of their less skilled members. Thus, while highly skilled people were underpaid, the reverse became true for unskilled employees. At the same time, pay levels of unskilled workers were above those in the private sector. These relatively high wage levels were certainly a factor behind poor financial performance.

Management selection and motivation became major problems. As inflation proceeded, the salaries of managers and other staff members declined in real

terms and fell even further behind pay in the private sector. By that time, pay in the private sector for managers and highly skilled technicians exceeded that in the public sector, and all government agencies, including the SPO, HCB and SIB experienced high turn-over of skilled people and unfilled posts. Another factors were the practice of changing most managers with a change of government and political interference. An additional problem was lack of incentives, which applied both to managers and workers. There were no real penalties for poor performance, also there is no competition among plants. A major issue was the quality and timeliness of the information flows required to execute these centralized functions effectively or to monitor performance. In certain cases the internal information flows no better than those going outside the enterprise to the government.

It may be concluded that the poor performance of the SEE had lots of causes. Some of them are:

- a. The organizational structure of the enterprises generally is not consistent with their basic functions and responsibilities. Gaps in responsibilities, friction, duplication, and insufficient coordination and communication are apparent. Some important functions such as finance, marketing, investment, etc. have not been organized in a manner necessary for smooth functioning.
- b. In general, insufficient attention is paid to the elaboration of yearly or long-term programs and the definition of policy objectives. As a result the work objectives and duties of middle and lower level administrators are not defined either.
- c. Many of those who occupy key positions do not possess knowledge of their functions, powers and responsibilities within the organization. Nor have they mastered the techniques necessary for profitability and productivity.
- d. An efficient communication and reporting system has not been developed to managers make timely and effective decisions.
- e. The importance of efficient and simple administrative procedures is not sufficiently appreciated.
- f. There is generally an excessive complement of officers, engineers and workers while, at the same time, there is an insufficiency of personnel at some levels. This suggests that qualified manpower is not distributed in a balanced manner within the enterprise or between the different enterprises.
- g. The significance of the personnel function, specifically manpower planning and administration and training of manpower is not well understood.

The marketing function has not been sufficiently developed. Currently this function is being carried out by sales departments; techniques of marketing generally are not known and applied; production control is either not carried out or insufficiently

developed. Industrial engineering is not taken seriously; there is no effective system of quality control; the system of central inventory control has led to an excessive and unnecessary accumulation of inventories; technological research and development activities have been neglected.

It was the inward-orientated strategy that was responsible for the adoption of an economically inefficient pattern of import substituting investments. The imposition of a mandatory investment program also reduced flexibility in meeting new economic conditions or the lack of adequate finance for the investment program. It was also the political progress that exacerbated the problems day-to-day interference, inappropriate investment choice, job insecurity for managers, and unreasonable wages and price control during the inflationary period. Finally, it was because the SEEs were never seen as really independent, but rather as departments of state. The prevalence of this view explained the low salaries of managers and lack of incentives and rewards for them, the absence of an adequate audit, the lack of the coordination among enterprises and between ministries and enterprises, lack of effective research analysis of supplies and markets, and a desire for secrecy about SEE performance that led to almost complete lack of effective public accountability.

## **2. Changes of SEEs since 1980**

Since the beginning of 1980 a series of changes in policy towards state enterprise have occurred in control over prices, investment allocation and finance, capital structure, personnel policy, and in the style of relations between government and individual enterprises.

### ***a. Pricing***

The Price Control Committee was abolished in January 1980 and almost all SEEs were free to set their own prices, but the pricing autonomy of SEEs did not turn out quite as it was assumed. The enterprises continued to ask for permission, usually via the Ministry responsible, to raise prices and such permission was not always granted. Price increases have been the main explanation for improved financial performance. At the same time, complete price freedom is an undesirable way of solving the financial problems of monopolists. The consequence can easily be reduced to control costs, including investment costs, and a shifting of the burden of SEE inefficiency from citizens via the treasury to users via high prices.

#### *b. Allocation of investment*

There has been an attempt to rationalize the allocation of investment expenditures towards high priority projects that will bear fruit within a reasonable period of time. The aim of the 1981 program was to allocate funds to projects in infrastructure, especially energy; to projects that improve capacity utilization; and to projects that do not overlap with the private sector.

#### *c. Financing*

Methods of financing investment have also changed. In 1981 loans for investment were made from the budget to profitable state enterprises via the SIB. Loss-making enterprises continue to receive loans directly from the budget, which avoids damaging SIB's financial position, but from 1981 this occurs only after scrutiny of the project by SIB and under SIB's supervision during implementation.

#### *d. Personnel*

The major problem for SEEs is the overstaffing. For this reason, the 1981 program decree frozen the number and structure of positions for existing operations in each SEE at their levels as Nov. 30, 1980. New factories opened by a SEE must first draw on existing staff of that SEE, and in any case new hiring may not exceed 50 per cent of the workforce for the plant. Vacant posts can only be filled with the permission of the Ministry. Early retirement and retirement of 40 per cent of the present labor force in the next five year will cut total employment in the operational SEEs.

Apart from these changes, SEE have been affected by changes in the trade regime, the exchange rate, monetary policy and the political climate. One effect of these changes has been to take the enterprises somewhat closer to the realities of the market place. Another has been to release them from the negative effects of politically-motivated interference.

These policy changes creates two fundamental problems in the short term. The first is that, for the managers, the only obvious way out of immediate financial pressures is either to raise process or to borrow. The freeze on employment levels gives little immediate room for reductions in costs, although in the medium term for cost reductions of various kinds are possible. If such reductions are to occur, not only will investment have to be oriented towards that end but management will have to be given greater freedom to control major cost items. The second question is whether managers have any incentive to make the decisions that will lead to cost reductions. The issue of pay structure and reward for managers remains outstanding.

## **D. PROPOSED REFORMS**

It is clear that the problems, from which SEEs suffered in the 1970s, are virtually identical to those which the reforms of almost two decades ago were supposed to solve. This experience shows that the problems of the SEEs are both deep-seated and unlikely to be resolved by modifying the legal framework and organizational structures alone. The need to define the problems to be solved by a reform without going into details, which must be specific to each industry, and without restricting the discussion to questions of reorganization. The starting point has to be how the SEEs will fit into the new outward-looking, market oriented policy. A successful policy transition will be very difficult if SEEs remain inefficient and the tax the rest of the economy via high prices or large deficits financed by government.

Many problems of SEEs could be resolved if they were made subject to the competitive pressures of the market and the prices they faced were undistorted by subsidies and protection. There are several reasons for taking this approach: first, profits can be the goal in the context of such a competitive market. Without such a single clear goal, the inevitable need to select among conflicting objectives tends to force decisions to rise to the highest political level. At the same time, without an efficient pricing environment, profit maximization will lead to economic inefficiency. Secondly, downstream industries with a comparative advantage will be penalized, unless prices are at international levels. Thirdly, it is easy to evaluate managerial performance by the criterion that will also be the goal of the enterprise. Fourthly, the discipline imposed by the profit benchmark provides the best incentive to the enterprise to improve efficiency. Finally, the need to remain competitive will be the strongest possible constraint on excessive wages, excess employment, and featherbedding.

### **1. Structure of enterprise**

How large should the enterprises be? An answer to this question cannot be given, especially since the technical characteristics of individual industries, including the potential for economies of scale vary. When we look at the steel industry, it would probably be appropriate to separate plants. In turn, the paper mills, cement mills and textile mills could develop more efficiently under separate administrations than under the present monolithic leadership. Lightening the corporate structure would provide an added impetus to competition, facilitate new initiatives, and make possible new combined ventures of public and private enterprise as well as disposal of certain elements of the state holding to the private sector.

The purpose of SEE and the changes to be made when industries mature are much debated issues in Turkey. The rationale for SEEs, as the pioneer of new industries, implies that older industries should be passed over to the private sector. Public manufacturing may continue to play a useful role in basic industries, such as fully integrated steel, fully integrated fertilizers, and basic petrochemicals, whose capital requirements are very large. This is not likely to be the case in the engineering industries where private initiative is needed to ensure the flexibility necessary to respond to world market conditions. There is no particular economic rationale for state enterprise in textiles, leather, shoes, sugar or cement.

## **2. Management and manpower**

It is vitally important that the managing director be appointed, and replaced on professional and managerial merit alone, independent of political considerations, that is remuneration be roughly equal to that offered for comparable jobs in private industry, and that he has a proper board rather than full-time board members looking over his shoulders.

At the moment when objectives are defined clearly and performance is measured objectively, the problem of management will disappear. Where any significant failure of a SEE would be clearly visible to the public eye, no government could afford to call on any but the best available managerial talent. If published results were indicative of performance, companies would work hard to maintain favorable rank.

There are four issues which are selection of managers, security for managers, accountability of managers, and pay and incentives for managers. With respect to the first three, many of the problems of SEE could be reduced if they had boards that were largely independent of the government and that did not see day-to-day management as their prerogative. The government may select boards whose members have security of tenure and the majority of whom are independent and have wide experience of business problem. These boards could then select the managers and have the sole power of dismissal. If there were also an independent General Assembly for the enterprises, such a body could select auditors as well as some board members.

The situation with respect to productivity, staff incentives, and working conditions is roughly follows:

- a. Measures must be developed that will show productivities and economic efficiencies of all SEEs.

- b. Plants in which substantial overmanning exist must be barred from hiring additional personnel to replace those that leave.
- c. Uneconomic plants should be closed. No SEE should be allowed to cite a social service function, such as retaining redundant workers on its payroll, as a reason for poor financial performance.

The pay scale and working conditions of workers and professional staff in SEE should be aligned with those in the private sector, thus removing the cause of dualism.

One of the most challenging task facing the group of SEEs is to involve workers in decision-making and to make them more cognizant of the fact that is the quality and quantity of their effort which determines their contribution to the national product and, in the long run, the size of their pay envelopes.

### 3. Finance

Under the present law, projects whose economic and technological eligibility have been established by the responsible authorities are presented to the SIB for financing. If SPO is willing to underwrite their economic eligibility, however, projects can be made financially viable through the price increases or state subsidies. If the Bank doesn't like the projects, its findings can be overruled by a council. Even project that are not financially viable must be financed by the Bank when they have been supplied with a Treasury guarantee. In contrast, under the proposed new system, the importance attached to a project by SPO and the Ministry of Industry will be determined, in the final analysis, by the amount of the subsidy they are willing to pay - subject also to their overall budgetary ceilings. With the subsidy fixed, the enterprise would present its project to the SIB, which would judge it strictly on its financial merits.

If the SEEs were fully autonomous and subject to market discipline, their initial equity capital could provided by the government and all further borrowing could come from the capital market without a guarantee and on exactly the same terms as those facing major private borrowers. Then there would be no need for a separate financial institution like SIB, or it would be better for the SIB to become integrated into the investment department of a unified state social insurance and pension fund. It might be better served by a professionally managed social insurance fund, having on its board representations of both the public and private sectors and directed by law to allocate its funds strictly according to financial criteria, without regard for their destination, whether it be the public or the private sector.



#### **4. Audit and accountability**

SEEs are subject to financial, administrative, and technical control by High Control Board (HCB). The activities of the HCB are governed by a special decree. The Board consists of twelve members and a Chairman and has a staff of about 130 specialists in technical, financial and legal matters. The Board, formally attached to the office of the Prime Minister, submits condensed annual reports on all SEE to a joint parliamentary committee which in turn form subcommittees that deal with individual enterprises. Parliament has the final word in releasing the boards of individual enterprises from their responsibilities for past operations. During the auditing function the HCB is principally concerned with administrative and financial aspects rather than business strategies and economic returns. The auditing of accounts cannot be done usefully until the prices faced by SEEs reflect economic reality. The same objective is, ofcourse, important if profit-oriented activities are to be efficient. Apart from the rational pricing of output and inputs, this would necessitate adjusting accounts for inflation and making the cost of capital comparable to that facing private enterprises.

The above discussion, provides some criteria for evaluating the scope and content of current proposals. The government has been given the issue of State Economic Enterprise reform considerable attention. The guiding principles of the reform are unexceptionable. They include; minimization of political interference; decentralization of decision making, so that enterprises can operate like private firms; rationalization of the structure of individual SEEs; clarification and concentration of responsibility for control of SEE; rewards for success, especially for managers of SEE.

#### **5. Structural reorganization**

SEEs can be divided into two categories. The first comprise public-utility type SEEs which would continue to function under law 440. The second comprise those SEEs that are to produce goods and services competitively, they would be removed from under law 440 and function under private enterprise laws. The productive SEEs would be organized into holdings, each of which would have a number of subsidiary companies. Each holding would have a full-time chairman, five part-time board members, and a general manager, all elected for five year terms, by the shareholders' meeting or general assembly to be held annually. The assembly would be concerned with general policy issues, it would appoint the managers of the subsidiary companies and it would provide overall directives to the subsidiaries.

The general assembly, to meet annually, would consist of the representatives of the Prime Minister's office, the Ministries of Finance, Commerce, Industry, Agriculture, Customs, and Tourism, the SPO, the HCB, the SIB and the subsidiary companies, as well as seven members to be chosen among experienced public and private sector managers. Holdings with private shareholders would also have private representatives. Overall policy guidance for holdings would be provided by a high level government Coordination Committee. The performance of manufacturing SEEs would be monitored by the Ministry of Industry on the basis of preference indicators on a quarterly basis with semiannual reports to be prepared for the use of the government.

Managers would have responsibility to increase output productivity and profits. Employees would receive incentive payments for performance. The holdings would be self-financing, with budgetary transfers limited to equity infusions for new investments. The proposal for increasing the decision-making power of the managers and making them responsible to a general assembly. At the same time, the effective responsibilities of the high-level Coordinating Committee and the role of the ministries monitoring the performance would be clear. Another thing is need for greater competition. It would be better to have more SEE competing with one another.

## VI. CONCLUSIONS

In Turkey, the state had a stake in economic affairs, either in terms of orientation of economic life or in terms of state managed enterprises, both before and after the Republic.

Prior to the formation of the Republic, state-owned enterprises were operated by the Ministries of Defence, Treasury and Armaments. Following the Republic, they were administered by the General Directorate of Military Factories and the Ministry of Finance. In the early years of the Republic, the economic role of the state could be seen as fostering the necessary environment for the development of a liberal economy. In this period, the state, instead of developing the productive potential of the state-owned enterprises, and reorganizing them to increase their effectiveness, continued to operate them as they were. No new establishments were formed and the existing ones were continued to be operated as branches of the central administration.

After the 1930s, a considerable number of State Economic Enterprises (SEEs) were established with different legal structures. The attempts at reforming and reorganizing the administration of these enterprises increased in frequency; more complex and wider issues were handled at each attempt in view of the growing number and economic importance of SEEs [Ref. 20: p. 259]. Since 1960, the scope of SEEs' economic activities has been further extended, in spite of their continued operation at low levels of productivity under inefficient management.

These enterprises which were originally considered to be the tools of the state economic policy on the one hand, and expected to be managed profitably and efficiently on the other, have not been able to renew themselves in time and therefore face severe problems at present.

Many attempts have been made up to now to study the problems of the SEEs and offer solutions. Many committees and commissions have been formed for this purpose. The task has finally been given to the State Planning Office (SPO) [Ref. 21: p. 19]. This organization, however, has identified its task as giving guidance to the SEEs which are responsible for developing and implementing their own organizational development programs.

When the reorganization attempts are carefully reviewed and analyzed the following shortcomings can be observed:

- a. With certain exceptions, the demands, attempts and recommendations for the reorganization of the SEEs have almost always been imposed upon them by some other public organizations such as the related ministry, SPO or the reorganization or reform committees formed by new governments.
- b. Reorganization studies have, in general, been carried on by the temporary committees or commissions and such efforts have not been continuous.
- c. Recommended solutions have not been based upon sophisticated research.
- d. Organization development efforts have not sufficiently been coordinated by a central body.
- e. Enterprises have not been held responsible for such studies.
- f. SEEs have not been able to implement most of the recommendations formulated in the reorganization project reports.

The fourth five year plan envisaged the reorganization of SEEs as "Sector Holdings", capable of stepping up capital formation in the economy, providing employment, producing indigenous technologies, realizing the production and export targets of the plan and providing a balanced industrialization, both sectorwise and in spatial terms. A sector holding would coordinate, at the top level, the economic, managerial, and financial activities of the parent SEEs which were to be integrated horizontally and/or vertically into the holding. Production, investment and marketing activities would be carried out by the General Directorates which would function at the second tier possessing legal personalities. The main characteristics of the reform were as follows:

- a. SEEs as a whole will be covered by a single and general legal status.
- b. They will be grouped in a limited number of establishments, functioning well and organized efficiently.
- c. Financial institutions affiliated to sector holdings will be created, or, if they exist, strengthened.
- d. A uniform employment status for SEE personnel will be provided.
- e. The Supreme Auditing Council will be reshaped to perform a well-defined economic auditing functions.
- f. All additional funds for SEE investments, according to the plan and annual programs will be provided by the SIB under the coordination of the SPO.

Finally as remarked before, quite apart from the need for the SEEs to improve their efficiency so as to provide savings, their transformation is a vital aspects of Turkey's modernization. It may be useful therefore, to repeat the main requirements:

that the SEEs be concerned mainly with efficiency and competitiveness and not with providing employment or a subsidized service; that the SEE managers be given as much autonomy as possible to achieve this aim but be required to justify their investment proposals under intense scrutiny; that the pay and tenure of managers be adequate to attract the right people and that their selection be based on their qualifications and not on political considerations; that SEE accounting, control and financial reporting should be such as to provide management with adequate and prompt information and to enable outside receiving agencies to see how efficiently each SEE is performing. The reviewing agencies and the public should learn to ask these efficiency questions about the SEEs and to appreciate that this kind of criteria should be used when judging whether an expansion should best take place by private enterprise or by an SEE.

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